IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

No. 3693.

ERNA KORN and MUTUAL SECURITIES COMPANY,
Appellants,

vs.

SPOKANE & EASTERN TRUST COMPANY, THE B. SCHADE BREWING COMPANY, B. SCHADE and L. R. STRITESKY,
Appellees.

IN EQUITY. Appeal from the District Court, Eastern District of Washington, Northern Division.

Appellant's Brief

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INLAND-AMERICAN PTG. CO.

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STATEMENT.

This suit was instituted by Erna Korn, a resident and citizen of the State of New York, against the Spokane & Eastern Trust Company and The B. Schade Brewing Company, corporations, organized

and existing under and by virtue of the laws of the State of Washington, and having their principal place of business at Spokane in said state, being citizens and inhabitants of the Eastern District thereof, and against B. Schade and L. R. Stritesky, citizens and residents of the State of Washington and the Eastern District thereof. The bill of complaint was filed by Erna Korn, a stockholder of the Brewing Company, in her own behalf and on behalf of other stockholders who might join and contribute to the expense. After due service, but one of the defendants appeared and answered. Subsequently to the joinder of issue by the plaintiff, Erna Korn, and the defendant, Spokane & Eastern Trust Company, and before the trial thereof, the Mutual Securities Company, a corporation organized and existing under and by virtue of the laws of the State of Minnesota, petitioned and was permitted to intervene in said cause as a party plaintiff, the relief sought being identical with that prayed for by the plaintiff. In due time a trial of the cause was had and a final decree of dismissal was entered dismissing plaintiff's and intervenor's complaint, from which decree an appeal has been taken by them to this Court. For the sake of brevity, hereinafter, the defendant, The B. Schade Brewing Company, will be spoken of as the Brewing Company, the defendant, the Spokane & Eastern Trust Company, as the bank, and the Mutual Securities Company, as intervenor, and the plaintiff and other defendants by their proper designations. It is admitted as is al-

leged in the complaint, that plaintiff is now and has been since the 23rd day of August, 1907, the owner of 50 shares of the capital stock of the Brewing Company (See Trans., p. 25); and that the Intervenor is the owner and holder of 200 shares of its capital stock; that the Brewing Company was organized in 1903, its existence to continue for a period of fifty years, and its objects were as follows, to-wit:

> "To brew, manufacture and sell beer and to carry on and conduct a general brewing and malting business, and to purchase all materials that may be necessary for the purpose of carrying on and conducting a general brewing and malting business; also to acquire, purchase and sell real as well as personal property of every nature and kind, for the purpose of carrying on and conducting a general brewing and malting and bottling business; also to build and erect breweries, malt houses and bottling works in any part of the State of Washington, Idaho, Oregon, California and Montana, and to purchase all things necessary and proper for the purpose of carrying out of the objects of this corporation or any part of them." (See Trans., p. 4 and 24.)

It is further admitted that at the time of the organization of said Brewing Company, its capital stock was $150,000, which was increased in June, 1905, to $250,000, and again in April, 1907, to $750,000. That the present capital stock of said company is divided into 7500 shares of the par value of $100 each; that there is now outstanding 5000 shares of said capital stock; that said corporation

has a board of three trustees, and since April, 1917, Sophia Schade, the defendants, B. Schade and L. R. Stritesky, have constituted such board. It is further admitted that the defendant, B. Schade, now and has been the president, and L. R. Stritesky its secretary, since the date of its organization. (See Trans., p. 24.) It is further admitted that in pursuance of the objects of its organization, said Brewing Company purchased the real property described in plaintiff's complaint and during all of the times mentioned used the same in the active prosecution of the objects of its organization. The said property constitutes practically all the holdings of the said Brewing Company. That on or about the 24th day of January, 1918, the defendant, B. Schade, was the president, and the defendant, L. R. Stritesky, was the secretary, and they, together with Sophie Schade, wife of said B. Schade, constituted the board of trustees of said Brewing Company. That the said B. Schade as president, and the said L. R. Stritesky as secretary, conveyed all of the said property of the Brewing Company to the said bank by that certain warranty deed which has been duly recorded in Book 355 of Deeds at page 599 of the Records of Spokane County, State of Washington. That the property in said deed described is set forth in plaintiff's complaint (See Trans., p. 7-9). It is further admitted that contemporaneous with the execution and delivery of said warranty deed, the defendant bank, as party of the first part, entered into a certain agreement with the defendant Brew-

ing Company and the defendant, B. Schade, a copy of which is attached to plaintiff's complaint and made a part hereof, marked Plaintiff's Exhibit "A". That the plaintiff was a shareholder at the time of the execution of said warranty deed and agreement, and this suit is not a collusive one to confer on the court jurisdiction of which it would not otherwise have cognizance.

The plaintiff and intervenor makes the further allegation, which is denied by the defendant bank, that the Brewing Company in pursuance of the objects of its organization, purchased the real property described in said deed and agreement for a consideration of approximately $100,000, and thereafter expended in building on said property approximately the sum of $250,000, and for the installation of machinery and equipment therein an additional sum of approximately $100,000, and that said property is at the present time reasonably worth the sum of $350,000, and was all essential and necessary for carrying into effect and execution the objects of said corporate organization, and without it the active life of said corporation is suspended. The plaintiff makes the further allegation, which is denied by the defendant bank, that the said Schades owned and had control of a majority of the shares of the capital stock of the Brewing Company, and exercised arbitrary control over the affairs and management of said company, and still are such officers and still continue to exercise such ownership and control with absolute disregard of the rights of the minority

stockholders thereof. It is further alleged that while acting as such officers, said defendants, B. Schade and L. R. Stritesky, purporting to act in behalf of the said corporation, and in violation of the rights of the plaintiff and all other minority stockholders, and without previous authorization of either the Board of Trustees or the stockholders of said company, and in transgression of its charter provisions, and with the intent and for the purpose of making and securing certain personal advantages over the other stockholders, conveyed all of the said property of the Brewing Company to the bank on the 24th day of January, 1918, and that contemporaneous with the execution and delivery of said deed, entered into that certain agreement, marked Plaintiff's Exhibit "A", which was intended to and did secure to the defendant, B. Schade and Sophia Schade, his wife, the right to the individual use of said property for a year and six months without rental, and they were released from all personal liability by reason of their having signed certain notes sued upon by the State Finance Company. That said concessions were made to the said B. Schade and wife as an inducement or consideration for his execution of that certain deed or conveyance. It is further alleged and testified to by the plaintiff and not controverted by any testimony on the part of the defendant bank, "that during all of the times herein mentioned, the plaintiff has resided at New York City, New York, and had no notice or intimation of whatever kind of the execution of the foregoing

mentioned conveyance or agreement, and never consented or assented to any such acts or become cognizant of their performance until on or about the first day of June. 1919, when the plaintiff was informed of the same by the said B. Schade. That thereafter the plaintiff employed counsel, and as she is informed and believes and therefore avers, that on or about July 15, 1919, said counsel on her behalf made demand upon said Brewing Company and its said managing officers and trustees, to bring or cause to be brought an action against the defendant bank to set aside as illegal and void said warranty deed and agreement, and said Brewing Company and its officers refused to bring any such action or to take any steps for an avoidance of said deed and agreement. That said B. Schade and Sophia Schade, his wife, are still in possession and charge of said property."

It is further alleged by plaintiffs, and denied by defendant bank, "that the acts complained of are fully executed and completed, and the plaintiff is informed and believes and therefore avers, beyond the power of the Brewing Company or its managing officers to have said deed and agreement set aside without resort to a court of equity; that the plaintiff is remediless at law and the exercise of the equitable powers of this court are necessary to redress plaintiff's wrong and injuries aforesaid in the conveying of all of the property of the Brewing Company and the suspension of its corporate life

contrary to the statute in such cases made and provided, and in violation of the rights and privileges of the plaintiff."

In addition to the foregoing denials, the defendant bank has set forth three affirmative defenses:

First. That the property in question was conveyed to the defendant in payment and satisfaction of an indebtedness of the Brewing Company, and that no part thereof has been paid.

Second. That plaintiff has been guilty of laches.

Third. That in paragraph I (See Trans., p. 28) it is stated in substance that prior to October 1, 1914, the Brewing Company borrowed of the bank $50,000, which was used in its business, and on October 5, 1914, executed a mortgage on all its property to secure the payment of the same.

In paragraph 2 (See Trans., p. 29) it is stated that "prohibition of the manufacture and sale of intoxicating liquors within the state of Washington destroyed the business of the Brewing Company and rendered it incapable of paying its debts or of paying the taxes on its property." It is further alleged in substance that the mortgage was assigned to the State Finance Company, a subsidiary corporation of the bank, which made some disbursements on account of delinquent taxes and insurance and then brought suit to foreclose, and that pending that suit, at the solicitation and request of the Brewing Company, an agreement, Plaintiff's Exhibit "A", was

entered into. In paragraph 3 (See Trans., p. 30), it is alleged that the Brewing Company was without defense to the foreclosure suit and the sole purpose of the arrangement was to relieve it of the costs of foreclosure suit and sale and probable deficiency judgment. The answer further alleges in substance that by virtue of said agreement the shareholders of the Brewing Company obtained, in effect, a period of redemption of eighteen months instead of one year, and made no offer to repurchase the property under the terms of said agreement. Lastly, it is alleged that the defendant bank offered to the stockholders of the Brewing Company an opportunity to become proportionate owners of the property conveyed by paying the defendant in proportion to the number of shares held. Plaintiff and intervenor deny that such offer was brought to their attention.

Plaintiffs allege that "the Schades owned and had control of a majority of the shares of the capital stock of the Brewing Company and exercised arbitrary control over the affairs and management of said company, and still are such officers and still continue to exercise such ownership and control, with absolute disregard of the rights of the minority stockholders thereof." The uncontroverted testimony of the defendant Stritesky is as follows:

> "Mr. B. Schade owned 2606 shares of a total of 5000 issued in the B. Schade Brewing Company (See Trans., p. 54). * * * For a number of years before the transaction ended, the

stockholders' meeting consisted of the Schades and myself, and the Schades and myself were at all times the board of directors, and the stockholders' meeting and the Board of Trustees' meeting have all been held at the same place.

Q. And you three people ran it?

A. We have—some of us ran it in a way.

Q. As a matter of fact, Schade ran it?

A. Yes, sir.

Q. Just as he pleased?

A. Pretty much so.

Q. From the date of the organization down to the time the thing went up in smoke?

A. I think that is very nearly correct.

Q. Well, it is practically absolutely correct, isn't it?

A. I think you are right there." (See Trans., p. 63.)

The record in this cause does not present any seriously controverted questions of fact except as to the value of the property in question. The value of the property, while not controlling, is material from the viewpoint of appellant and of itself presents a vivid illustration of the necessity of the enforcement of the law as contended for by appellant to avoid fraud and injustice of the most aggravated type. Plaintiff alleged that the value of the property was $350,000, while the highest estimate placed upon it by the several witnesses testifying on behalf of plaintiff was $357,000. The minimum valuation placed upon it by Mr. Colburn, a real estate dealer, and the only witness of the defendant testifying as to the value of the property in its entirety, was $100,000. His lack of qualification to testify

to the value of the building, machinery and brewery equipment leaves his testimony on this question very unsatisfactory, as against the positive testimony of those qualified. Mr. Merryweather, a stockholder and director of the bank, hit the low water mark when he valued the real estate separate from the building, in January, 1918, at $20,000. (See Trans., p. 85.) The lowest valuation placed upon the building at that particular date was by the defendant, L. R. Stritesky, an experienced architect and builder, and was $184,057 (See Trans., p. 69), which would make the property, aside from the machinery and equipment, worth $204,057. To this should be added the uncontroverted testimony of Mr. Lang (See Trans., p. 74), that the machinery and equipment was worth from $30,000 to $35,000, and the value of the ice machine sold under stipulation on April 23, 1920 (See Trans., p. 122), for $12,000, making a total valuation of $351,057. That the property was much more valuable than the price paid by the defendant bank can hardly be controverted, for in its letter to the stockholders of the Brewing Company it is frankly stated, "It is believed that there is a substantial equity in the value of the property in excess of the amount of the investment of the Spokane & Eastern Trust Company." (See Trans., p. 166). If the trial court is correct in holding in this cause that the President and Secretary of the Brewing Company had absolute power of disposition of all of the property of the company, that they could convey to whom they

pleased, when they pleased, and without any restriction whatever, and for such consideration as they saw fit, payable to the corporation or to themselves personally, then the question as to whether the property was worth $50,000 or $650,000 would be immaterial; otherwise it is apparently very material as showing one of the dominating elements of fiduciary relationship—the good faith of the trustees of the corporation and its stockholders—if on no other ground.

ASSIGNMENTS OF ERROR.

(1) The Court erred in dismissing plaintiff and intervenor's complaints on the ground that the trustees of The B. Schade Brewing Company had power to enter into the agreement (Plaintiff's Exhibit "A") and execute the conveyance mentioned in paragraph 7 of plaintiff's complaint, for the reason that there is no controversy over the facts; that said contract is prima facie invalid, showing a violation of the fiduciary relation which exists between the trustees and the company and the trustees and individual stockholders in this: that the officers executing the same received certain rights and concessions in said agreement mentioned as an inducement for its execution not enjoyed by the minority stockholders of said corporation; that the execution of the contract and the conveyance of all of the corporate properties thereunder was contrary to the Charter of The B. Schade Brewing Company, in violation of the statutes of the State of Washington, and an

infringement upon the rights of the minority non-consenting stockholders.

(2) The court erred in dismissing plaintiff's and intervenor's complaints on the ground that the trustees of The B. Schade Brewing Company could dispose of all its corporate property without the unanimous consent of all the stockholders, for the reason that it is contrary to its Charter, in violation of the statutes of the State of Washintgon and of the individual rights of the minority non-consenting stockholders.

(3) The court erred in dismissing plaintiff's and intervenor's complaints on the ground that the president and secretary of The B. Schade Brewing Company could dispose of all of the property of said corporation without the previous authorization of the board of trustees and all of the stockholders, for the reason that it is contrary to its Charter, in violation of the statutes of the State of Washington and of the individual rights of the minority non-consenting stockholders.

(4) The court erred in dismissing plaintiff's and intervenor's complaints on the ground that the life of The B. Schade Brewing Company was not suspended by the conveyance of all of its property to the defendant Spokane & Eastern Trust Company, for the reason that said conveyance was contrary to the Charter of The B. Schade Brewing Company, in violation of the Statutes of the State of Wash-

ington and of the individual rights of the minority non-consenting stockholders.

(5) The court erred in dismissing plaintiff's and intervenor's complaints on the ground that the amendment of the State Constitution prohibiting the manufacture and sale of intoxicating liquors authorized the sale and conveyance of The B. Schade Brewing Company to the defendant Spokane & Eastern Trust Company in the manner and form alleged by plaintiff, for the reason that it is contrary to the Charter of The B. Schade Brewing Company, in violation of the statutes of the State of Washington and of the individual rights of the minority non-consenting stockholders.

(6) The court erred in dismissing plaintiff's and intervenor's complaint on the ground that the inability of the defendant, The B. Schade Brewing Company, to pay its debt to the Spokane & Eastern Trust Company authorized and empowered the president and secretary of the Brewing Company to convey all its property to the creditor company in the manner and form alleged, for the reason that it is contrary to the Charter of The B. Schade Brewing Company, in violation of the statutes of the State of Washington and of the individual rights of the minority non-consenting stockholders.

(7) The court erred in dismissing plaintiff's and intervenor's complaint on the ground that no fraud was committed or contemplated in the exe-

cution and procurement of the deed and contract between the defendants, The B. Schade Brewing Company and the Spokane & Eastern Trust Company, for the reason that the contract itself shows that the officers of The B. Schade Brewing Company were acting for their own interests in a manner destructive of the corporation itself and in violation of the rights of the minority non-consenting stockholders.

(8) The court erred in dismissing plaintiff's and intervenor's complaint on the ground that the mortgage from The B. Schade Brewing Company had been satisfied of record, for the reason that it is not material to the issues presented by plaintiff and intervenor and does not excuse or make right the wrong complained of.

(9) The court erred in dismissing plaintiff's and intervenor's complaint on the ground that the mortgagee had been placed in possession by the mortgagor and the mortgage debt had not been paid, for the reason that it does not afford a justification for the continued possession of the property wrongfully procured or for a violation of the rights of the minority non-consenting stockholders of The B. Schade Brewing Company.

(10) The court erred in dismissing plaintiff's

and intervenor's complaints on the ground that the utmost relief that could properly be granted to either The B. Schade Brewing Company or its stockholders would be the right of redemption, for the reason that the contract and conveyance to the Spokane & Eastern Trust Company was beyond the power and authority of the officers executing the same on behalf of The B. Schade Brewing Company, was invalid, in violation of the statutes of the State of Washington, and of the rights of the minority non-consenting stockholders, and in contemplation of law not the act of The B. Schade Brewing Company, so that its original right of ownership and possession were not changed thereby.

(11) The court erred in dismissing the plaintiff's and intervenor's complaints on the ground that it did not appear that either The B. Schade Brewing Company or its stockholders are ready and willing to pay the amount due on redemption, for the reason that it is not material, not an issue in this cause or a matter on which the rights of the plaintiff or the intervenor as stockholders depend or a question that could be adjudicated in this court and cause or that would effect the validity of the contract and conveyance complained of.

(12) The court erred in dismissing plaintiff's and intervenor's complaints on the ground that the complaints are entirely devoid of equity, for the reasons stated in each of the foregoing Assignments of Error.

(13) The court erred in making an entry of that certain decree on the 3rd day of November, 1920, absolutely dismissing plaintiff's and intervenor's complaints in this action, for the reason that the plaintiff and intervenor had the individual right to bring the action and to the relief prayed for; also for all the other reasons set forth in the foregoing Assignments of Error.

THEORY OF CAUSE.

Before proceeding to a discussion of the several specific assignments of error, it may be well to explain appellants' theory of this cause in relation to the allegations of plaintiff's complaint.

> "It is not necessary to allege fraud in terms." *Andrus vs. King County*, 1 Wash. 49.

While the word "fraud" is not used in the complaint, the language used charges fraud on the part of defendants as clearly as if it had been used a dozen times, nor would the use of the word add anything to the sufficiency of the allegations in this respect. The facts pleaded—the facts admitted—establish fraud as a conclusion of law. See *N. P. Ry. Co. vs. Clearwater County*, 26 Ida. 455, 465. The alleged violation of the statutes of Washington by the defendants, the acts of the officers of the Brewing Company in excess of the power conferred upon them, is fraud, and the provision in the agreement between the defendant bank, the Brewing Company, and its majority stockholder, president and managing agent, B. Schade, in agreeing and receiving a

virtual bribe in the nature of a release from certain personal obligations and free rent of corporate property, in opposition to the interest of the balance of the stockholders of the corporation that he represented, makes the contract prima facie, fraudulent and invalid. The evidence does not disclose the value of the consideration given by the bank to B. Schade personally. It may have been great; it may have been small; one thing is certain, the price was given and that it constituted a part of the moving consideration for the execution of the deed of the property of the Brewing Company so that a partial explanation of counsel who was then acting for the defendant bank of the motives that actuated the defendant, is not sufficient to rid the contract of its viciousness and fraud upon minority stockholders of the Brewing Company.

> "The theory of this class of suits is that a stockholder has a right that the operations of the corporation should be kept by the directors within the powers conferred by its charter; every measure which transcends those powers, although done in good faith, violates the rights which inhere in the ownership of stock, and puts the value of the stock itself at hazard. The suit may be brought by a single stockholder suing on his own account alone, or by a stockholder suing on behalf of himself and all others who are similarly situated. The corporation is, of course, made a co-defendant, and any other corporation or person who has joined in the *ultra vires* transaction may also be made a defendant." See Pomeroy's Equity Jurisprudence, Sec. 1093.

Appellants contend that the facts alleged in plaintiff's complaint are such as to show that this action can be maintained without showing any notice, request or demand, to the managing body of the Brewing Company or any actual refusal by them to prosecute. But, whatever view may be taken of the allegations of plaintiff's complaint in this respect, it at least must be conceded that it shows a case, if not of compliance with Equity Rule 27, facts, circumstances and conditions sufficient to excuse such compliance. See Delaware & H. Co. v. Albany & S. R. Co., 213 U. S. 449; Doctor v. Harrington, 196 U. S. 579, 49 Law Ed. 606. The rule contended for by appellants is also stated in Pomeroy's Equity Jurisprudence, Sec. 1095, as follows:

> "If the facts as alleged show that the defendants charged with wrong-doing, or some of them, constitute a majority of the directors or managing body at the time of commencing suit, or that the directors or a majority thereof are still under the control of the wrong-doing defendants, so that a refusal of the managing body, if requested to bring suit in the name of the corporation, may be inferred with reasonable certainty, then an action by a stockholder may be maintained without alleging or proving any notice, request, demand or express refusal."

This proposition seems to be supported by ample authority and has a very extended recognition, both in this country and in England.

In the case of *Mason vs. Harris L. R.,* 2 Ch. Div. 97, 107, Sir George Jessel, M. R., said:

> "As a general rule, the company must sue in respect of a claim of this nature, but general rules have their exceptions, and one exception to the rule requiring the company to be plaintiff is that where a fraud is committed by persons who can command a majority of votes, the minority can sue. The reason is plain, as, unless such an exception were allowed it would be within the power of the majority to defraud the minority with impunity."

See also *Cook on Corporations,* 5th Ed., Sec. 741.

At the trial the defendant introduced in evidence an amendment of said Articles of Incorporation, we assume for the purpose of showing a change of the powers thereof. Now, we contend that the interpretation of that amendment must be in harmony with the objects expressed in its original charter; that an amendment in parliamentary usage and an amendment of Articles of Incorporation are based on different grounds. *Cook on Corporations,* 5th Ed., Sec. 501, says in part:

> "The power to make amendments and to repeal and alter charters has been reserved in most of the states of the Union. It is clearly established that the legislature cannot, under this reserved power, amend the charter so as to change the whole character of the enterprise and compel the corporation to proceed under the amended charter. The restrictions of the state constitution still exist, and individuals cannot be forced by the state into new contracts. Moreover, the amendment must not be foreign to the purposes and objects of the original charter. * * * The Supreme Court of the United States has said that, 'a power reserved to the

> legislature to alter, amend, or repeal a charter authorizes it to make any alteration or amendment of a charter granted subject to it, which will not defeat or substantially impair the object of the grant, or any rights vested under it, and which the legislature may deem necessary to secure either that object or any public right."

The power of amendment has its limitations and the procedure which authorizes the increase of its capital stock does not authorize the change of the objects of its original charter. The increase of the capital stock can be made by a vote of two-thirds of the stockholders (See Rem. & Bal. Code, Sec. 3709. 3705), while to change the original charter would require the unanimous consent of all of the stockholders, and the procedure which authorizes the increase of its capital stock does not authorize the change of the objects of its original charter.

Plaintiff's and appellant's theory is, that the affirmative matter found in the defendant bank's answer does not constitute any defense whatever, as the following argument and analysis will show.

Does the fact that the bank loaned the Brewing Company money which was used in its business and not repaid, extinguish the fundamental rights of the stockholders to have the corporate affairs conducted under the provisions of its charter and the statutes of the state creating it? Does the fact that no offer of payment was made by the plaintiff make it inequitable for a court to set aside the conveyance secured under the conditions and circumstances of the case at bar? If the rights of the minority stock-

holders are dependent upon their ability to pay the debts of the corporation, whether contracted in violation of its charter and the statutes of the state, then they are certainly a snare and a delusion. In view of the fact that there is no rebutting testimony to that stipulated in plaintiff's Exhibit 1 (See Trans., p. 116), defendant's second affirmative defense ceases to be a defense. In the third affirmative defense, it is alleged that the defendant loaned the Brewing Company $50,000, the payment of which was secured by a mortgage on all its property. How can this be a defense to the illegality of the agreement and deed thereunder? It is also alleged that the prohibition act of Washington destroyed the Brewing Company's business and it suspended business without funds to pay any indebtedness or taxes on its property. Under the terms of its charter, the Brewing Company could have still conducted its business in the states of California and Montana, but conceding that the prohibition act destroyed the business of the Brewing Company in the State of Washington, what defense is that to the prima facie invalid agreement and deed thereunder? Did the prohibition act outlaw the fundamental rights of stockholders of the Brewing Company and take from them the right of having the corporate affairs conducted and wound up in acordance with the charter and statutes of their creation? It is further alleged in paragraph 2 of defendant's third affirmative defense, that the mortgage was assigned to the State Finance Company, a subsidiary corporation

of the defendant, which made some disbursements on account of delinquent taxes and insurance and then brought suit to foreclose. That pending suit at the solicitations and earnest request of the Brewing Company, agreement, Exhibit "A" was entered into. Does this furnish a defense against the violation of the rights of the stockholder—an avoidance of the illegal features of the contract—a sufficient excuse for the violation of the law? In paragraph 3 of defendant's third affirmative defense, it is alleged that the Brewing Company was without a defense to the foreclosure suit and the sole purpose of the agreement was to relieve the Brewing Company of the costs of foreclosure suit and sale and from a probable deficiency judgment. Appellants' feel to challenge the proposition that the Brewing Company was without defense to the foreclosure proceeding, in the light of the pleadings in said cause (See Trans., p. 124, 146, and 153), which disclose a defense not only on the part of the Brewing Company, but also on the part of B. Schade, whose alleged mental condition was equally applicable to the conduct of the affairs of the Brewing Company, as to his own personal affairs, but taking it for granted that the defendant bank was, in fact, playing the role of a philanthropist, does it furnish any defense as to the illegality of the agreement or the violation of the charter rights of the stockholders or the violation of the state statutes? It is further shown in paragraph 3 that the acts complained of are in effect an extension of the redemption period.

Does that constitute a defense, even if true? It is also alleged that no offer to repurchase the property under the terms of the agreement was made. Does that fact, if true, constitute a defense? If the contract is void a non-compliance of its terms would not cure its defects. And lastly, in paragraph 3 of defendant's third affirmative defense, it is alleged, we assume by way of defense, that the defendant bank offered to the stockholders of the Brewing Company an opportunity to become proportionate owners of the property conveyed by the Brewing Company, by paying to the defendant in proportion to the number of shares held, and some of the shareholders have accepted said offer. Plaintiff declined the offer. Does this constitute a defense? There seems to be still more ways than one of skinning a cat. This is an example of the genteel "freezing out" process applied to stockholders. An illustration, that those with money can profit by the violation of the charter rights of those without money.

ARGUMENT.

Assignments of Error Numbered 1, 2 *and* 3.

Assignments of error numbered 1, 2 and 3 are so closely related that brevity and clarity would seem to demand a single discussion of the principle involved, i. e., the power of the Brewing Company, its officers and agents, to enter into the contract and execute the deed referred to in plaintiff's complaint. Appellants, therefore, submit the following propositions on these assignments of error: First, that the

contract set forth in plaintiff's complaint which forms the basis of this action, is fraudulent upon its face, on account of the personal interest disclosed of the officers executing the same in behalf of the Brewing Company, in opposition to the interest of the balance of the stockholders of the company. Second, that the managing body or Board of Trustees of the corporation organized and existing under and by virtue of the laws of the State of Washington, cannot dispose of all of the corporate property in the absence of a charter provision permitting the same, without the unanimous consent of all the stockholders in a regularly called meeting of the stockholders for that purpose, and that any attempt to do so is a fraud upon the non-consenting stockholders, unless such action is taken under the statutory provisions for dissolution. Third, that the president and secretary of a corporation cannot dispose of all of the property of the corporation without the previous authorization of the stockholders and direction of the board of trustees, and that any attempt to do so is a fraud upon the non-consenting stockholders.

The contract set forth in plaintiff's complaint and which forms the basis of this action, is fraudulent upon its face on account of the personal interest of the officers executing the same in opposition to the interest of the balance of the stockholders of the company. On this question I wish to direct the court's attention to Exhibit "A" (See Trans., p. 18-19), which states in part:

> "It is further understood and agreed that if during the lifetime of this option * * * B. Schade or Sophia Schade, his wife, shall personally operate a business in said bottling works, that no rental shall be charged therefor as long as said business is conducted by said Schades personally."

And in paragraph 6 it is sated (See Trans., p. 19):

> "Upon the execution of this option and agreement, that the action pending in the Superior Court of Spokane County, entitled State Finance Company vs. B. Schade Brewing Company, et al, will be dismissed with prejudice, and without costs, and that all notes and said mortgage shall be cancelled and surrendered to said second party, and that no recourse shall be had as against said B. Schade or said Sophia Schade, personally, on account of signing said notes."

To such an agreement as this, the law imputes fraud and affords relief. In considering this proposition, it must be remembered that there exists fiduciary relationship between the stockholders and the officers of the Brewing Company so that the question of fraud rests on entirely different grounds to that of actual fraud in law, where the scienter must be alleged and proven. Mr. Pomeroy, in his work on Equity Jurisprudence, 3rd Ed., Sec. 955, 966, in discussing this question of constructive fraud, said:

> "It is of the utmost importance to obtain a correct conception of the exact circumstances under which the equitable principle now to be examined applies; otherwise the entire discus-

sion of the doctrine will be confused and imperfect. In the various instances described in the preceding paragraphs, there has been an actual undue influence consciously and designedly exerted upon a party who was peculiarly susceptible to external pressure on account of his mental weakness, old age, ignorance, necessitous condition, and the like. The existence of any fiduciary relationship was unnecessary and immaterial. The undue influence being established as a fact, any contract obtained or other transaction accomplished by its means is voidable, and is set aside without the necessary aid of any presumption. The single circumstance now to be considered is the existence of some fiduciary relation, some relation of confidence subsisting between two parties. No mental weakness, old age, ignorance, pecuniary distress, and the like, is assumed as an element of the transaction; if any such fact be present, it is incidental, not necessary—immaterial, not essential. Nor does undue influence form a necessary part of the circumstances, except so far as undue influence, or rather the ability to exercise undue influence, is implied in the very conception of fiduciary relation, in the position of superiority occupied by one of the parties over the other, contained in the very definition of that relation. This is a most important statement, not a mere verbal criticism. Nothing can tend more to produce confusion and inaccuracy in the discussion of the subject than the treatment of actual undue influence and fiduciary relations as though they constituted one and the same doctrine."

"It was shown in the preceding section that if one person is placed in such a fiduciary relation toward another, that the duty rests upon him to disclose, and he intentionally conceals a material fact with the purpose of inducing the

other to enter into an agreement, such concealment is an actual fraud, and the agreement is voidable without the aid of any presumption. We are now to view fiduciary relations under an entirely different aspect; there is no intentional concealment, no misrepresentation, no actual fraud. The doctrine to be examined arises from the very conception and existence of a fiduciary relation. While equity does not deny the possibility of valid transactions between the two parties, yet beecause every fiduciary relation implies a condition of superiority held by one of the parties over the other, in every transaction between them by which the superior party obtains a possible benefit, equity raises a presumption against its validity, and casts upon that party the burden of proving affirmatively its compliance with equitable requisites, and of thereby overcoming the presumption."

In the case of *Hyams vs. Calumet-Hecla Mining Company,* 221 Fed. 530, the following language is used:

"A minority stockholder may maintain a suit in equity in his own name for relief where the board of directors or a majority of them are acting for their own interest and in a manner destructive of the corporation itself or the rights of other stockholders."

"The Bigelow case does not, however, decide that a court of equity could not, and should not, give appropriate relief for the protection on the part of the controlling corporation to absolutely dominate the controlled company, and the existence of a substantial conflict of interest between such companies accompanied by an actual attempt to accomplish a prejudicial domination. On the other hand, the rule, indepen-

dently of state or national anti-trust statutes, is fundamental that one in control of a majority of stock and of the board of directors of a corporation occupies a fiduciary relation towards the minority stockholders, and is charged with the duty of exercising a high degree of good faith, care, and diligence for the protection of such minority interests. Every act in his own interest to the detriment of the holders of the minority stock becomes a breach of duty and of trust, and entitles to plenary relief from a court of equity. Jackson vs. Ludeling, 88 U. S. (21 Wall.), 616, 624, 625, 22 Law Ed. 429; Jones vs. Electric Co. (C. C. A. 8), 144 Fed. 771, 75 C. C. A. 631; Wheeler vs. Abilene etc. Bldg. Co. (C. C. A. 8), 159 Fed. 391, 394, 395 89 C. C. A. 477, 16 L. R. A. (N. S.) 892, 14 Ann. Cas. 917; 3rd Clark & Marshall on Corporations, p. 2289."

In the case of *Winthrop Iron Co. vs. Meeker,* 109 U. S. 180, 27 L. Ed. 898, it is said:

"The stockholders of a corporation which has a lease, were operating an iron mine on 50c a ton royalty, being unable to get a renewal of the lease, purchased a majority of the stock of the lessor corporation. They called a meeting which was attended by themselves only, voted an expenditure of $50,000 from the lessor's capital, to sink a shaft to facilitate the operation of the mine, and directed an 18 year lease of the lessor's mine and property at a royalty of 25c a ton on the ore mined together with certain other advantages to the lessee. Held, on a bill filed by stockholders in behalf of themselves and all other stockholders, that the renewal of the lease was inequitable, and a fraud on the rights of the stockholders not concurring therein."

Our own supreme court says in the case of *Parsons vs. Tacoma Smelting & Refining Co.,* 25 Wash. 497, 498:

> "The policy of the law forbids a trustee to assume a double function where there are adverse interests considered. 1 Waterman, Corporations, p. 614, observes that they cannot, as agents or trustees, enter into or authorize contracts on behalf of those for whom they are appointed to act, and then personally participate in the profits. Morawetz on Corporations lays down the rule that the utmost good faith is required in the exercise of the powers conferred on trustees. In Munson vs. Syracuse, etc. R. R. Co., 103 N. Y. 58 (8 N. E. 355), the court observed of a contract: 'We are of the opinion that the contract of Sept. 14, 1875, is repugnant to the great rule of law which involves all contracts made by a trustee or fiduciary, in which he is personally interested, at the election of the party he represents. There is no controversy as to the facts bringing the case as to Munson within the operation of the rule. He and his associates are dealing with a corporation in which Munson was a director, in a matter where the interests of the contracting parties were or might be in conflict. The contract bound the corporation to purchase; and the corporation in assuming the obligation and binding itself to pay the price primarily agreed upon between the plaintiffs and Magee. He stood in the attitude of selling as owner and purchasing as trustee. The law permits no one to act in such inconsistent relations. It does not stop to inquire whether the contract or transaction was fair or unfair."

Quoting again from Pomeroy on Equity Jurisprudence, Sec. 1075, III, *To act with good faith.*

The duty not to deal with trust property for his own advantage, says:

"Absolute and most scrupulous good faith is the very essence of the trustee's obligation. The first and principal duty arising from the fiduciary relation is to act in all matters of trust wholly for the benefit of the beneficiary. The trustee is not permitted to manage the affairs of the trust, or to deal with trust property, so as to gain any advantage, directly or indirectly, for himself, beyond his lawful compensation. * * * It is equally imperative upon the trustee, in his dealing with trust property, not to use it in his own private business, or to take any incidental profits for himself in its management and not to acquire any pecuniary gains from his fiduciary position."

Sec. 1077, Id. 3, *The duty not to accept any position or enter into any relation, or do any act inconsistent with the interests of the beneficiary.* "This rule is of wide application, and extends to every variety of circumstances. It rests upon the principle that as long as the confidential relation lasts the trustee or other fiduciary owes an undivided duty to his beneficiary, and cannot place himself in any other position which would subject him to conflicting duties, or expose him to the temptation of acting contrary to the best interests of his *cestui que* trust. The rule applies alike to agents, partners, guardians, executors and administrators, directors and managing officers of corporations as well as to technical trustees. The most important phase of this rule is that which forbids trustees and all other fiduciaries from dealing in his own behalf with respect to matters involved in the trust, and this prohibition operates irrespectively of the good faith or bad faith of such dealing. It is therefore a gross

violation of his duty for any trustee, or director, acting in his fiduciary capacity, to enter into any contract with himself connected with the trust or its management; such a contract is voidable. and may be defeated or set aside at the suit of the beneficiary."

"Breach of duty and abuse of fiduciary obligation do not necessarily involve intentional moral delinquency. If the act amounts to what the law considers a breach of trust and disregard of duty, it is sufficient."

Hyams vs. Calumet Hecla Mining Co., 221 Fed. 559.

In considering the law on the question of the powers of the Brewing Company, its officers and agents, the facts must be clearly kept in mind. That B. Schade was the President and L. R. Stritesky the Secretary, and that they together with Sophia Schade, the wife of B. Schade, constituted the Board of Trustees. That the board of trustees constitute the governing body of the company, and that they as a board never authorized the President and Secretary to execute the deed and agreement in question. (See, Trans. p. 55). But it is contended that while there was no preauthority, that there was a ratification by the Board of Trustees at their meeting of February 4, 1918. (See, Trans. p. 56). If it be admitted that B. Schade and wife were disqualified from entering into a contract in behalf of the corporation where their personal interest was involved, for like reason they would be unable to ratify the contract. On June 9, 1921, the Supreme

Court of the State of Washington handed down an important decision involving the questions herein discussed, and affirming the principles announced in the case of Parsons v. Tacoma Smelting & Refining Co., *Supra.* The case is entitled Sacajawea Lumber and Shingle Co. v. Skookum Lumber Co., et al. 198 Pac. 1112, and the following language is used:

> "A director of a corporation occupies a strictly fiduciary capacity and it is always his duty to fully represent the interest of the corporation of which he is a director. While there is some authority to the contrary, the majority of the courts and text writers hold that a director in a private corporation has no power to vote upon a proposition wherein his individual interest is opposed to that of the corporation which he represents. At page 92, 14 (A) C. J., the rule is stated as follows:
>
> 'A director who is disqualified by personal interest from voting on a particular matter before the meeting cannot be counted for the purpose of making a quorum or a majority of the quorum. The act done is invalid where his presence is necessary to constitute a quorum, or where his vote is necessary to the passage of the resolution, regardless of the fairness or good faith of the transaction' * * *"

"In the case of Burns v. National Mining, Tunnel & Land Co., 23 Colo, App. 545, 130 Pac. 1037, the court said:

> 'A board of directors of a solvent corporation may borrow money from one or more individual members of the board, and give the corporation's note for it, and even mortgage the cor-

porate property to secure it, where the transaction is in good faith * * * If the presence and vote of the director loaning the money is necessary to constitute a quorum, and to make a majority upon such vote, however, the act is voidable at the instance of the corporation or its stockholders. The trust relation existing between the directors and the stockholders of a corporation ought not to permit such an act, and a court of equity will scrutinize all contracts made in this way and set them aside, regardless of the good faith of the transaction.'

'At 10 Cyc. P. 790, the rule is stated as follows:

'A director cannot with propriety vote in the board of directors upon a matter effecting his own private interest any more than a judge can sit in his own case; and any resolution passed at a meeting of the directors at which a director having personal interest in the matter voted will be voidable at the instance of the corporation of the shareholders, without regard to its fairness, provided the vote of such director was necessary to the result.'

'See, also, the following cases to the same effect:

'Heublien v. Wight, 227 Fed. 667; Curtin v. Salmon River etc. Co. 130 Cal. 345, 62 Pac. 552, 80 Am. St. 132; O'Rourke v. Grand Opera House Co., 46 Mont. 609, 133 Pac. 965; United States Rolling Stock Co. v. Atlantic & Great Western R. Co., 34 Ohio St. 450, 32 Am. Rep. 380. Other cases involving this question may be found in the cases above cited.

'But the question under discussion is not a new one to this court. In the case of Parsons v. Tacoma Smelting & Refining Co., 25 Wash. 492, 65 Pac. 765, we said: ' '

Appellants hardly feel justified in making further citation from this case, but ask this Court's consideration of the same on the questions involved in these three assignments of error.

> "One dealing with the officers and agents of a corporation created by statute is bound to take notice of the extent of their authority as limited by the act of incorporation."

12 *Century Digest, Corporation,* Sec. 1721.

> "One who deals with officers or agents of a corporation is bound to know their power and the extent of their authority. The corporation is only bound by their acts or contracts which are within the scope of their authority."

12 Century Digest, Corporations, Sec. 1720; McCormick v. Market Nat'l Bank, 165 U. S. 538.

In considering the second proposition, *supra,* it should be borne in mind that the Brewing Company was organized for the manufacture and sale of beer and not for the building and selling of brewery plants. It has been held in this state that mining corporations organized for the buying and selling of mining property could sell all its property in the regular course of business, where such power was expressed in its charter. Such were the holdings in Pitcher vs. Mining Co., 39 Wash. 608; Lang vs. Mining Co., 48 Wash. 167; Logie vs. Mining Co., 106 Wash. 208. But the rule announced in those cases are certainly not applicable to the case at bar, for no such power is expressed in the Brewing Com-

pany's charter. The rule applicable and followed in the State of Washington is expressed in the cases of Parsons v. Tacoma Smelting and Refining Co., 25 Wash. 497-8; and Theis v. Spokane Falls Gas Light Co., 34 Wash. 27. It was never intended in the later cases to overrule or modify the doctrine therein stated, which is in harmony with reason, the common law, and the great bulk of adjudicated cases. See, Sacajawea Lumber & Shingle Co., v. Skookum Lumber Co. et al., 198 Pac. 1112. By taking into consideration the admissions contained in defendant's answer to the objects of the Brewing Company, which must be assumed as controlling, it becomes apparently a simple matter to arrive at the proper measure of the rights and obligations of its stockholders. It is stated in 10 Cyc. 406:

> "The general rule is that the relation between a corporation and a shareholder, being one of contract, any legislative enactment which without his assent authorizes a material or fundamental change in the power or purpose of the corporation, not in aid of the original object, if acted upon by the corporation, is not binding upon him."

> "Selling the entire corporate property to another corporation, or what is in practical effect the same thing, leasing it for 999 years, is such a fundamental change as releases a dissenting subscriber. If this cannot be done with the authority of the legislature so as to bind a dissenting shareholder, for stronger reasons it cannot be done without the authority of law." Id., 408.

"The legislative change in the character of the enterprise which will thus release a subscriber, has been often described as material, fundamental or radical; but it is more frequently described by the use of the word 'fundamental.' If it vitally and radically affects rights established and fixed by charter, it cannot be enforced upon an unwilling shareholder." Id., 408.

It is said in the case of *Parsons vs. Tacoma Smelting & Refining Co.,* 25 Wash. 497, 500:

"The articles of incorporation of a corporation constitute a contract entered into by all the stockholders, whose terms cannot be abrogated without the consent of all, hence, a lease of the corporate property authorized by a majority vote of the stockholders is voidable at the suit of a non-consenting stockholder where the articles of incorporation contain no express power to make such lease."

"Each individual stockholder assumed the liability of the payment of his subscription to the capital stock in money or moneys' worth and the corporation engages to carry on the business for which it was organized."

"The stockholders have equal rights to participate in the profits of the business accruing to the value of the stock owned by each, and each stockholder is entitled to the protection of his charter rights. He may insist that the business be conducted according to the articles; and while the wishes of the majority of the stockholders are potent in the administration of all of the business of the corporation, and where exercised without fraud or oppression, are controlling upon the minority, yet the action of the majority cannot prevail where it impairs the contract right of a stockholder."

Every reason that may be advanced for the formation of corporate organizations furnishes an appeal for the enforcement of the contractual obligation of the individual stockholder and the corporation. The methods of procedure must be observed and enforced, for they are a part of the fundamental rights that inhere in the ownership of stock.

Taking up now the third proposition, appellants contend that one of the fundamental contract rights of each shareholder of the Brewing Company, which we contend has been violated in this case, is to have the power of the corporation exercised by the stockholders and board of trustees as designated by the statute of its creation (See, Secs. 3708 and 3686, Rem. & Bal. Code). The stockholders and board of trustees must act as such and not individually, or in any other capacity, therefore, formal action is required in the exercise of corporate power. The rule announced by the Supreme Court of the United States in the case of *De La Vergne Refrigerating Co. vs. German Savings Institution,* 175 U. S. 40, 44 L. Ed. 65, is applicable and illustrative of plaintiff's contention, and is as follows:

> "A conveyance of the assets of a corporation is not within the power of the stockholders, even though they all sign it, without formal action at a meeting held for that purpose. * * * In addition to this, however, there was no corporate action taken authorizing any such conveyance by the corporation, and such conveyance would not, under the law of Illinois, which conforms in this particular to the general

law, be within the power of the stockholders even though they all signed it without formal action at a meeting held for that purpose." (Many authorities cited).

It is stated in the case of *Humphreys v. McKissock,* 140 U. S. 313, 35 Law Ed. 475:

"The property of a corporation is not subject to the control of individual members, whether acting separately or jointly. They can neither encumber or transfer that property, nor authorize others to do so. The corporation—the artificial being created—holds the property and alone can mortgage or transfer it; and the corporation acts only through its officers, subject to the conditions prescribed by law. In Smith v. Hurd, 12 Met. 385, the relation of stockholders to the rights and property of a banking corporation are stated with his usual clearness and precision by Chief Justice Shaw, in speaking for the Supreme Court of Massachusetts, and the same doctrine applies to the relations of stockholders in all business corporations. Said the Chief Justice: 'The individual members of a corporation, whether they should all join or each act separately, have no right or power to intermeddle with the property or concerns of the bank, or call any officer, agent or servant to account or discharge them from any liability. Should all the stockholders join in a power of attorney to any one, he could not take possession of any real or personal estate, any security or chose in action; could not collect any debt or discharge a claim or release damages arising from any default, simply because they are not the legal owners of the property, and damage done to such property is not an injury to them. Their rights and their powers are limited and well defined."

The exercise of the rights and powers of the Brewing Company are well and definitely defined by the statutes of Washington,—the statutes of its creation,—and by those statutes the exercise of general corporate power is confined to a board of trustees, See, Sec. 3686 Rem. & Bal. Code, while the power of dissolution rests in the hands of the stockholders, See, Sec. 3708, Id. Plaintiff and intervenor therefore contend that the deed and contract set forth in their bill of complaint should be declared illegal and void; first, because no action was taken by the board of trustees or its stockholders in the premises, either directing the execution of the conveyance or its ratification. The mere announcement by its unauthorized officers amounts to neither. Plaintiffs have alleged and proven that no action was taken by the board of trustees or stockholders in the matter of the execution of the deed and agreement conveying all of the property of the Brewing Company. That this extraordinary transaction, involving the very existence of the corporation, should not be considered in the same light that every day business transactions of a going concern are considered, is self evident. It is not a question of the power of the officers of the Brewing Company to liquidate the debts of the company in the due course of business, but a question of the dissolution of the corporation, by an unauthorized sale of all its corporate property, in violation of the plain provisions of the statute and the articles of incorporation of the company, so that the same rule of

reasoning does not apply, for no estoppel or part performance can sustain a contract that is forbidden by a charter or is contrary to statute. In discussing the question of the enforcement of such contracts, Cook on Corporations, 5th Ed. Sec. 681, says in part:

> "The courts differ widely in their decisions on the enforcibility of *ultra vires* contracts. * * * In the Federal Courts, on the contrary, the ordinary rules against *ultra vires* contracts is upheld in all its rigor and applied with all its severity. The tendency of modern jurists to relax on that subject finds no favor in the federal courts."

In note 5 to said section it is said:

> "The doctrine of *ultra vires* by which a contract made by a corporation beyond the scope of its corporate power, is unlawful and void, and will not support an action, rests, as this court has often recognized and affirmed, upon three distinct grounds; the obligation of any one contracting with a corporation to take notice of the legal limits of its powers; the interests of the stockholders not to be subject to the risks which they have undertaken, and above all, the interest of the public that the corporation shall not transcend the powers conferred upon it by law." McCormick v. Market Bank, 165 U. S. 538, 549. * * * No estoppel or part performance can sustain a contract that is forbidden by charter or is contrary to public policy." See, also, Oregon Railway and Nav. Co. vs. Oregonian Railway Company, 130 U. S. 1; Penn. R. R. Co. v. Keokuck etc. Co., 131 U. S. 371, 384, 389.

ASSIGNMENT OF ERROR NUMBERED 4.

Assignment of error numbered four (4), goes to the question of the suspension of the corporate existence of the Brewing Company, on the sale of all its property to the bank. Aside from other considerations, the statutes of the State of Washington controlling the creation and existence of corporations, provides the method of dissolution, which of course, is exclusive, and becomes one of the charter rights of the stockholders, and cannot be disregarded without unanimous consent of the stockholders. As previously stated, it is not a question of the power of the officers of the Brewing Company to liquidate the debts of the company in due course of business, but a question of the dissolution of the corporation, by sale of all its corporate property, in violation of the plain provisions of its articles of incorporation and the statute relative to procedure. See, Sec. 3708 Rem. & Bal. Code, which in part is as follows:

> "Any corporation formed under this chapter may dissolve and disincorporate itself by presenting to the superior judge of the county in which the office of the company is located a petition to that effect, accompanied by a certificate of its proper officers, and setting forth that at a meeting of the stockholders, called for the purpose, it was decided, by a vote of two-thirds of all the stockholders, to disincorporate and dissolve the corporation."

In contruing a like statute from the state of Ore-

gon, the Supreme Court of the United States held, that it was not a part of the general powers of a corporation. See, Oregon Railway & Nav. Co. v. Oregonian Railway Co., 130 U. S. 35, and stated,

> "It does not need argument to show that such provision, made for the dissolution of a corporation by the voluntary act of the incorporators, providing for the disposition of its property when the resolution to that effect has been adopted, whether by distribution of dividends on its profits or the sale of shares of stock, or for any other disposition of its effects compatable with law, is not applicable to and cannot be intended to confer upon corporations continuing in existence, or which, like these companies, contemplate in the very contract entered into a continuance of more than ninety-six years the power to dispose of their corporate power and franchises, much less the power to lease them for an indefinite period to others."

The Supreme Court of the State of Washington in the case of Parsons v. Tacoma Smelting & Refining Co., 25 Wash. 497-8, said.

> "Reason as well as authority, we think, will sustain the proposition that neither a majority of the stockholders nor the directors of a corporation as such, without special authority for the purpose, can generally do an act which, to all intents and purposes, terminates the corporation."
>
> "It is conceded that at common law a corporation had no power to dissolve excepting by universal consent of the stockholders, and that an injunction would be granted upon the appli-

> cation of a single stockholder to prevent such dissolution." Theis v. Spokane Falls Gas Light Co., 34 Wash. 27.
>
> "The sale of the entire property of a corporation without compliance with the statute is a dissolution." Id. 24.

As stated in the case of Andrews v. National Foundry & Pipe Works, 76 Fed. 171, the Washington decision, above cited,

> "Being the first direct ruling of the Supreme Court of the state upon the exact question under consideration, must be regarded as establishing a construction of the statute which the federal courts will follow without further inquiry." (See, —— numerous authorities there cited).

There is no question in relation to the fact of the sale of all the property of the Brewing Company, under the terms of the contract and admissions of the defendants, without any attempt at a compliance with the statutes of dissolution. Here then is fraud incontestably established as a conclusion of law.

ASSIGNMENT OF ERROR NUMBERED 5.

Assignment of error numbered five (5), is, that the trial court erred in holding that the amendment to the state constitution, prohibiting the sale and manufacture of intoxicating liquors, authorized the sale and conveyance of all the property of the Brewing Company to the defendant bank. The trial Court in arriving at this conclusion stated, "The

business which the Brewing Company was organized to promote * * * became unlawful by reason of the amendment to the state constitution." The fact that the Brewing Company was organized to conduct the same class and kind of business in the states of California and Montana, was totally disregarded, so that the Court arbitrarily assumed without the slightest evidence to support the proposition, that the Brewing Company was no longer a going concern and that in a sense it was insolvent. While contending that these conclusions are not justified by the evidence, yet, for the purpose of meeting the question fairly, assuming the correctness of the conclusions of the trial Court, the question arises, does the fact that one corporation owes another corporation, justify the absolute disregard of the statutes and remove all restraints from the action of its officers? Does the fundamental rights of the stockholders cease immediately on the corporation becoming indebted? Does such a condition leave the officers at liberty to pay the debt with *all* the corporate property, regardless of the amount of property or indebtedness? Appellants contend, that corporate indebtedness must be paid but that such payment must be made in accordance with the statutory provisions creating the corporation, and in conformity with the fundamental rights of the stockholders. That if the conclusions of the trial Court be taken as correct, that after the adoption of the constitutional amendment the Brewery Company was no longer a going concern, then it should

have been dissolved in accordance with the statutes of the state and its articles of incorporation, and not in a manner in violation thereof, however seductive it may be made to the personal interest of the controlling stockholders and managing officers thereof, as illustrated in this cause. In the case of Mason v. Pewambic Mining Co., 133 U. S. 50, 33 Law Ed. 524, the well recognized rule is stated:

> "The rights of stockholders in regard to the assets of an expiring corporation do not differ from those of partners on the dissolution of the partnership. * * * On the dissolution of the corporation the majority cannot place a valuation on the assets of the corporation any more than can a minority of the stockholders, and each are entitled to have all the assets sold and proceeds divided. * * * Such right in the absence of an agreement to the contrary, is to have the property converted into money, and its value ascertained, by sale, even though a sale is not necessary to the payment of debts."

In the case of Hunt v. American Grocery Co., (C. C.) 81 Fed. 532, the following language is used:

> "The directors of the G. Co., a corporation, organized under the laws of New Jersey to conduct a manufacturing and mercantile business, called a meeting of the stockholders to consider the propriety of a sale of the business. Less than one-third of the stock was represented at the meeting, but a resolution was passed by a large majority of the stock represented, instructing the directors to dispose of the business of the company on such terms as they should deem best. Held, that the statutes fully pro-

> vided for the winding up of the corporation in case its business was unprofitable, or it was obliged to suspend for a want of funds, the directors should be enjoined, at the suit of a stockholder, from disposing of the assets, so as to prevent the corporation from carrying out the object of its incorporation."

The trial Judge in citing the case of Lange v. Reservation Mining and Smelting Company, 48 Wash. 167, which is not analogous to the case at bar, draws an incorrect inference from the dicta, when he states, (See, Trans. p. 44).

> "It may be that a solvent private corporation conducting a successful business in this state may not sell out or abandon the corporate enterprise over the protest of a minority stockholders."

Appellants contend that, under the statutes of the state of Washington, the rights of the stockholders are not contingent upon the solvency or success in business of the corporation. The stockholders have a fundamental right to have the affairs of the corporation conducted in acordance with the mandates of the statute, and that right does not depend on its solvency or insolvency, upon its debts or its credits, whether it be sucessful or not sucessful, but exists with full force and virtue under all conditions that a corporation may find itself. The very idea of such modifications on the rights of stockholders is not only abnoxious to a fair intendment of the statutes but to every principle of justice and equity.

ASSIGNMENT OF ERROR NUMBERED 6.

Assignment of error numbered six (6) goes to the holding of the trial Court, that the inability of the Brewery Company to pay its debts as they became due in the ordinary course of business, clothed the President and Secretary with power to convey all its corporate property to one creditor regardless of its value, the personal inducements extended to the officers making the conveyance by the bank and the statutes of the state concerning the conduct of corporate affairs. On this question the trial Court stated,

> "After the adoption of this amendment the corporation was no longer a going concern, and if not insolvent in the sense that its debts exceeded its assets, it was at least insolvent in the sense that it could not pay its debts as they became due in the ordinary course of business. Finding itself in this plight, only one course was open to it. That was to dispose of its property, pay its debts, and distribute the surplus, if any, among its stockholders. No other course has been suggested by counsel, and no other course suggests itself to the Court. The power of the trustees to do this without the consent of all the stockholders, so long as they acted in good faith, does not in my opinion admit of question."

It will be observed that the trial Court assumes that the board of trustees of the Brewing Company, acted in the premises, when the facts show, that the president and secretary alone acted personally and not as a board of trustees. In passing on this as-

signment of error it is necessary to determine the real questions involved in this cause. It is plainly evident that the paramount question within the perview of the trial Court, is the payment of the indebtedness to the bank. All other questions are not only subordinated to the lone question of the liquidation of the debt to the bank, but absolutely disregarded. The fact is not mentioned and apparently not considered, that all of the corporate property essential for carrying on corporate business, of the value of some $350,000.00 was turned over by the President and Secretary of the Brewing Company, in discharge of the personal obligations of its President and other inducements mentioned in plaintiff's Exhibit "A", for the equivocal indebtedness of some $63,000.00. No mention is made of the statutes prescribing the method of procedure under the stated conditions to accomplish the very purpose suggested by the trial Court, i. e., the payment of the corporate indebtedness and the closing up of its affairs, so that the rights of the stockholders might be safeguarded. The defense of indebtedness to the bank is made to overshadow all other questions, including constitutional rights of contract, state statutes and provisions of articles of incorporation. It in fact constitutes the keynote of the trial Court's decision, despite the issues presented by the pleadings and proof. Appellants therefore, once more re-assert, that the question is not, has the governing body of the Brewing Company authority to pay its debts? but, under the pleadings and proof in this cause, has

the Secretary with the President who owns the majority of the Capital Stock and who ran the corporation as he pleased, the right to dissolve the corporation at will regardless of the articles of incorporation, the rights of the minority stockholders, and the statutes of its creation? The appellants answer, that the president and secretary either as such officers, or in their capacity of trustees, have no such power or authority. The rights of the body of stockholders to dissolve a corporation cannot be questioned, or the statutory procedure disregarded. See, Sec. 3708, Rem. & Bal. Code. The question of dissolution is the one involved under the pleadings and proof, and not the subterfuge of payment of debt raised by the defendant and solely considered by the trial Court; for the payment of corporate debt must perforce be subject to the statutory provisions and not in violation thereof. Under the statutes of Washington the right or power of dissolution is given to the stockholders and cannot be regarded as one of the general powers of a corporation. See, Oregon Railway & Navigation Co. v. Oregonian Railway Co., 130 U. S. 35.

ASSIGNMENT OF ERROR NUMEBRED 7.

The seventh assignment of error goes to the question of fraud. The trial Court held that no fraud was committed or contemplated in the execution and procurement of the deed and contract between the Brewing Company and the bank. As heretofore

stated in appellants theory of this cause, "it is not necessary to allege fraud in terms," where the language used in the complaint charges fraud on the part of the defendants. The facts alleged from which the ultimate facts of fraud must be drawn are plainly unmistakeably alleged, proven and admitted. Thus the contract, plaintiffs' Exhibit "A" is *prima facia* invalid. First, because this extraordinary instrument does not even recite the preliminary steps necessary and essential by the stockholders and trustees to convey all the property of the corporation. Second, because the contract discloses the personal interest of the parties executing the same on the part of the Brewing Company. Third, because it is in open violation of the statutes of the state of Washington.

Under the statutes of Washington Sec. 3686 Rem. & Bal. Code, it is expressly provided that the power of a corporation shall be exercised by a board of not less than two trustees. No suggestion is made in the contract that the president and secretary were acting on the direction of the board of trustees. If the contract was signed "The B. Schade Brewing Co., by Don Quixote and Rip VanWinkle" its invalidity would not be more apparent, under the statute. But for the purpose of argument, disregarding the Washington statute, *supra,* the general rule seems to be and is supported by the great weight of authority, that a president has no inherent power to represent or contract for a corporation, even in every

day business transactions; aside from where its corporate existence is involved. See, Cook on Corporations, Sec. 716. It should be borne in mind, that the very nature of the contract removes it from the category of the every day business transaction, and places it in a class by itself, and thereby disposes of any presumption of power and authority of officers and agents of corporations in the usual and ordinary business transactions, indulged in in some jurisdictions.

The second proposition suggested that the contract discloses the personal interest of the officers executing it on behalf of the Brewing Company, is in direct violation of the rule "which forbids trustees and all other fiduciaries from dealing in their own behalf with respect to matters involved in the trust, and this prohibition operates irrespectively of the good faith or bad faith of such dealing. It is therefore a gross violation of his duty for any trustess or director, acting in his fiduciary capacity, to enter into any contract with himself connected with the trust, or its management;" See, Pomeroy's Equity Jurisprudence, Secs. 1075, 1077; Hyams v. Calumet-Hecla Mining Co., 221 Fed. 530, and the cases therein cited, and Parsons v. Tacoma Smelting and Refining Co., 25 Wash. 497-498. That the officers of the Brewing Company, have subscribed their names to plaintiffs' Exhibit "A" which shows a palpable violation of duty and breach of trust. The facts also show that the defendant bank was privy

to the fraud, in fact participated in it. Appellants submit that the transaction would not have been more inequitable by the bank agreeing and giving the sum of ten thousand dollars to Schade and wife personally for the execution of the deed. That the bank was a party to the fraud, by agreeing to give to Schade and wife the free use of the property for eighteen months and releasing them from all liability on certain notes sued upon by the State Finance Company, just as much as though the consideration had been in cash, and of such amount as would have tempted the cupidity of the managing officer of the Brewing Company to violate his duty and commit a breach of trust. In defining the term "breach of trust" Pomeroy in his work on Equity Jurisprudence, Sec. 1079, says:

> "It might be supposed that the term 'breach of trust' was confined to willful and fraudulent acts which have a *quasi* criminal character, even if they have not been made actual crimes by statute. The term has, however, a broader and more technical meaning. It is well settled that every violation by a trustee of a duty which equity lays upon him, whether willful and fraudulent, or done through negligence, or arising through mere oversight or forgetfulness, is a breach of trust. The term therefore includes every omission or commission which violates in any manner either of the three great obligations already described; of carrying out the trust according to its terms, of care and diligence in protecting and investing the trust property, and of using perfect good faith."

That the officers of the Brewing Company committed a breach of trust—a violation of duty—in accepting what must be regarded as a virtual bribe on the part of the bank, and together committed a fraud on the minority stockholders of the Brewing Company can hardly be gainsaid.

That the contract is in open violation of the statutes of Washington is evident from the contract itself as well as the admitted facts in the cause, and that both parties fully understood that it meant a conveyance of all the property of the Brewing Company, and necessarily a suspension of its corporate functions is equally clear. Both the officers of the Brewing Company and the bank, knew that no effort had been made to comply with the provisions of Sec. 3708 of Rem. & Bal. Code, and both parties must be presumed to know the law as announced by the Supreme Court of Washington, to wit; "The sale of the entire property of a corporation without compliance with the statute is a dissolution." See, Theis v. Spokane Falls Gas Light Co., 34 Wash. 24. Appellants assume that it will not be seriously contended, that the president and secretary, even under the stated conditions of this cause, had a right to dissolve the corporation. The right of stockholders to a statutory dissolution is fundamental. Necessarily the violation of the right is an *ultra vires* act and therefore a fraud upon the corporation and its stockholders. In the case of Parsons v. Tacoma Smelting & Refining Co., 25 Wash. 500, it is stated,

> "The authority of the board of directors is derived from the unanimous agreement of the stockholders, expressed in their charter or articles of association; and hence those powers which it is intended shall belong to the directors exclusively cannot be impaired by the majority, or any other agent. Each agent is supreme within the scope of the powers delegated to him by his principal."

The statutes of the state of Washington reserve the right of dissolution in the stockholders and prescribe the method to be pursued by them. It is therefore a charter right, "and each stockholder is entitled to the protection of his charter rights. He may insist that the business be conducted according to the articles." Parsons v. Tacoma Smelting & Refining Company, *Supra.*

In this case the contract shows that the powers and functions of the stockholders and board of trustees have been usurped by the president and secretary. This is established by the contract itself, viewed in the light of the admitted value of the property, the statutes of the state of Washington, the holdings of the Supreme Court of the State, the fiduciary relationship of the parties and the personal adverse advantages and concessions accruing to the officers of the Brewing Company. These considerations conclusively show that fraud was committed and contemplated in the execution and procurement of the deed and contract in question. While it may be admitted that the contract itself shows, that it was not the intention of the parties to

dissolve the Brewing Company, such however was the result, and only emphasizes the fact of the usurpation of power and violation of the statutes by the president and secretary. It is evident that the parties to the contract contemplated a continuance of the existence of the Brewing Company, if not for a period of thirty-five years under the statute, at least for a year and six months, until the expiration of the redemption period mentioned in the contrct, so, that while it becomes apparent that it was not the intention to dissolve the corporation, its dissolution was a necessary result of compliance with the terms of the contract, which makes it *ultra vires*. See, Oregon Railway and Navigation Company v. Oregonian Railway Co., 130 U. S. 35.

ASSIGNMENT OF ERRORS NUMBERED 8 AND 9.

Assignment of error numbered eight (8) presents the proposition advanced by the trial Court, that the carrying out of the terms of an *ultra vires* or invalid contract cures its defects, nullifies the rights of the minority stockholders, disposes of the rule that, "one who deals with officers or agents of a corporation is bound to know their power and extent of their authority," and the doctrine of *ultra vires* by which a contract made by a corporation beyond the scope of its corporate powers is unlawful and void.

"A contract of a corporation which is *ultra vires* in the proper sense—that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred on it by the Legislature—is not voidable only, but is wholly void, and of no legal effect. The objection to such a contract is not merely that the corporation ought not to have made it, but that it could not make it. Therefore a contract cannot be ratified by either party, nor can performance on either side give rise to any obligations thereunder." Central Transp. Co. v. Pullman's Palace Car Co., 139 P. S. 24.; Durkee v. People, 155 Ill. 354, 40 N. E. 626; National Home Building and Loan Ass'n v. Home Saving Bank, 181 Ill. 35, 54 N. E. 619, 621; California Bank v. Kennedy, 167 U. S. 362, 367; Directors etc., of Ashbury Ry. Carriage & Iron Co., v. Riche, L. R. 7 H. L. 653; First Nat. Bank v. American Nat. Bank, 173 Mo. 153, 72 S. W. 1059, 1061; G. V. B. Min. Co. v. First Nat. Bank of Hailey (U. S.) 95 Fed. 23, 33, 36 C. C. A. 633.

The dissolution of a corporation is not a "corporate power" in the usual acceptation of the term, or in the statutory sense in defining "corporate power," but is a right reserved to the stockholders. So that the question of the satisfaction of the mortgage as presented in assignment of error numbered eight, is not material to the issues presented in the pleadings, nor does it present an estoppel or suspend the rights of the minority stockholders or the corporation in the premises.

The same principles and conclusions are applicable to appellants' Assignment of Error numbered

nine (9), and this Court is respectfully asked to give them consideration in connection therewith. As applicable to both assignments of error, appellants beg leave to submit the following statement from Central Transportation Co. v. Pullman's Car Co. 139 U. S. 55.

> "In Thomas v. Railroad Co., already cited, Mr. Justice Miller, while admitting in general terms that 'in many instances, where an invalid contract, which the party to it might have avoided or refused to perform, has been fully performed on both sides, whereby money has been paid or property changed hands, the courts have refused to sustain an action for the property or the money so transferred,' and that 'the executed dealings of corporations must be allowed to stand for and against both parties when the plainest rules of good faith require it,' yet in the same connection, and in the most emphatic words, said that in the case before the court, of a contract forbidden by public policy and beyond the powers of the defendant corporation, it was its legal duty, a duty both to its stockholders and to the public, to rescind and abandon the contract at the earliest moment, and the performance of that duty, though delayed for several years, was a rightful act when done, and could give the other party no right of action; and to hold otherwise would be 'to hold that any act performed in executing a void contract makes all its parts valid, and that the more that is done under a contract forbidden by law, the stronger is the claim to its enforcement by the courts.' 101 U. S. 86."

ASSIGNMENT OF ERROR NUMBERED 10.

Assignment of error numbered ten (10) is based on the ground of the holding of the trial Court, that. the utmost relief that could be properly granted the Brewing Company, or its stockholders in a suit of this character, would be the right of redemption. Here is again illustrated the narrow boundary of what the trial Court considered the only controlling question, i. e., the alleged debt of the Brewing Company to the defendant bank. Rights of the parties to this action are based and determined in the view of the lower Court on this single consideration. That it must necessarily constitute an erroneous basis becomes apparent from the fact that no issue was made or presented on the question by the pleadings; and obviously could not be directly material in passing on the *ultra vires* acts of the President and Secretary of the Brewing Company, in arbitrarily disposing of all its property of the value of more than $350,000.00 for an alleged indebtedness of some $63,000. The amount of indebtedness is not and cannot be made a material issue in this cause, but, before passing on the question and amount of redemption and making it a basis of decision, it would appear to be at least fair and equitable to judicially determine in the cause, the actual amount of indebtedness and not to irrevocably accept the one-sided statement of officers, whose own personal interests are admittedly involved while acting beyond the scope of their power. It will be observed, that, Mr. Justice Miller,

whose preeminence as authority on corporation law is universally admitted, did not predicate the duties of the corporation and its stockholders in the foregoing citation under assignment of errors numbered eight and nine, on the proposition that they should pay all the debts of the corporation before attempting to have an *ultra vires* contract set aside. It is only stating a truism to say that any act which transcends the power conferred by law on a corporation, even though done in its name by officers or agents, is not the act of the corporation. To hold otherwise would be to make limitless the power of a statutory creation limited by the statute itself. The acts of the officers and not the statutory regulation would control. Thus, the constitutional provision against the impairment of contractual obligations existing between corporations and its stockholders would be set at naught, and legislative enactments for the safeguarding of such right would cease to be of force or effect.

ASSIGNMENT OF ERROR NUMBERED 11.

Appellants' eleventh assignment of error is that the Court erred in dismissing plaintiff's and intervenor's complaints on the ground that it did not appear that either the Brewing Company or its stockholders are ready and willing to pay the amount due on redemption of the claim of the bank. Here again is illustrated the controlling influence with the trial Court. Why a court of equity should resolve itself into a partisan collection agency in

this particular instance, and ignore all other questions actually presented, is incomprehensible. Is it to be held in this action, that the plaintiff stockholder with fifty shares of capital stock whose par value is $5,000. must be prepared to pay the debt of the corporation amounting to possibly twenty times the amount, before she can insist on the enforcement of her rights as a stockholder, the right of the corporation and the duties of corporate management in a court of equity? If it were in law a condition precedent to the institution of a suit by the stockholders or corporation that all its debts be paid as per the provisions of an *ultra vires* contract, before the contract could be set aside or abandoned, then the plaintiff and intervenor would of course have no standing in court. But, such is not and never has been the law, as shown by the authorities herein cited. It is most probable and reasonable that the amount of interest of any minority stockholder, or their inability to pay the debts of the corporation would be a more effectual estoppel than any principal of law, regardless of the merits of their contention. But the debts of the Brewing Company to the bank, is not a question in issue in this cause or within the jurisdiction of this Court, and cannot be allowed to effect the validity of the contract and conveyance complained of, nor can it be allowed to becloud the true issue. The seeming solicitude of the trial Court for the payment of the bank before its right to retain all the property of the Brewing Company valued at $350,000.00 can be questioned,

seem to have caused a disregard of the real questions involved. In the case of Central Transportation Company v. Pullman's Car Co., 139 U. S., the same contention was made on the question of the validity of a lease, at page 31, to wit:

> "If the decision of the court below is sustained, it will retain everything that is valuable, and which it could never have acquired but for the lease, and will be obliged to return nothing but worthless cars."

and on page 37,

> "In conclusion we urge upon the court that the decision of the court below leaves the plaintiff in a most deplorable condition. Its contracts, which were valuable, are gone. The defendant under the lease is now in possession of all the contracts which were formally owned by the plaintiff. It has been denied the right to recover the sum agreed to be paid in the lease because the contract being against public policy. If it cannot recover upon the contract, how can it recover upon a *quantum meruit*? If it has no action at law how can it have any relief at equity?"

But such contentions and such questions did not effect the Supreme Court of the United States. The question involved was the validity of the contract, and on this question the Court stated, see page 60,

> "No performance on either side can give an unlawful contract any validity, or be the foundation of any right of action upon it."

Numerous cases cited in argument of assignment of error numbered eight are to the same effect.

ASSIGNMENT OF ERROR NUMBERED 12.

Assignment of error numbered twelve (12) is based on the holding and dismissal by the trial Court of plaintiff's and intervenor's complaint on the ground that they are entirely devoid of equity. The right of the defendant bank, if it ever had any, has not grown out of the deal involved in this action, i. e., the deed and agreement, so that rule requiring an offer to do equity is not applicable in this action on that ground alone. The defendants are asking no redress except the affirmation of what plaintiffs and appellants contend to be a fraudulent and *ultra vires* deed and contract, and if the Court should hold that the contract was either fraudulent or *ultra vires*, then it must follow that the defendant did not acquire any equity under its own unlawful contract in violation of the rights of innocent third parties. "One who deals with the officers and agents of a corporation is bound to know their power and the extent of their authority." Corporations and stockholders have certain rights, fundamental in their nature, guaranteed to them by the constitution and laws of the state, which all must take notice of and eliminates the necessity of any offer to do equity in case of their infringement. The proposition is tersely stated in the case of Franklin v. Hevelena Mining Co., 141 Pac. 727, as follows:

> "To require the plaintiff to tender defendant the expenditures, before permitting him to prosecute his suit would be the height of inequity, as it would endorse the proposition of

> forcing the owner of property to repay the trespasser moneys expended by him on the property as a condition precedent to the right of recovery."

On this question see also Citizens Saving & Trust Co. v. Illinois Cent. R. Co., 182 Fed. 607-613.

The defendant bank has made no defense of money paid, under the terms of the contract and deed. If such defense had been made, appellants would still contend, using the language of the Supreme Court of the United States in the case of M. & M. R. R. Co. v. Soutter, 13 Wall 517, 20 Law Ed. 543,

> "A fraudulent purchaser of property, when deprived of its possession, cannot recover for repairs or improvements nor for incumbrances paid while in possession. * * * He that hath committed iniquity shall not have equity."

And on the further ground, that while the contract is fraudulent it is also *ultra vires.* Citing from Central Transportation Co. v. Pullman's Car Co., 139 U. S. 59,

> "A contract of a corporation, which is *ultra vires,* in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, be-

> cause it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it."

It is further stated in said opinion on page 61,

> "Whether this plaintiff could maintain any action against this defendant, in the nature of *quantum meruit,* or otherwise, independently of the contract, need not be considered, because it is not presented by this record, and has not been argued."

ASSIGNMENT OF ERROR NUMBERED 13.

The thirteenth (13) Assignment of Error is based upon the decree absolutely dismissing plaintiff's and intervenor's complaints in this action. The facts disclosed by the pleadings admitted and proven in this cause, seem conclusive as to the right of the plaintiff to institute this action, so that appellants will simply direct this Court's attention on this point to the authorities cited under the head of "Theory of Cause," while on the other questions, properly debatable under this assignment, appellants have the following observations to make, based on the law and authorities heretofore cited, and which appellants deem controlling and conclusive in the premises.

A board of trustees cannot convey all of the assets of the corporation without the consent of all of the stockholders even where a valid consideration is given therefor. The transfer under discussion

was made without any official action on the part of the board of trustees. This was, in effect, a dissolution of the corporation, contrary to the law of the state governing such dissolutions. When a stockholder buys stock in a corporation he is assured by the law that the corporation will not be dissolved except in the manner provided by statute. Public policy as well as common fairness demands this. Any other rule would violate the law and would leave minority (sometimes a majority) stockholders at the mercy of a corrupt, indifferent or inefficient president and secretary. The facts of any particular cause do not effect this protecting rule unless, possibly, the invalid act is approved by *all* of the stockholders, and even then the rule is not effected but the remedy is lost because the stockholders would be estopped to repudiate the action of the trustees.

A further objection and one emphasizing the foregoing is that part of the alleged consideration for giving the deed was that the Schades were to use the property without rent for a period of eighteen months and they were to be released from their *personal* obligations as makers of the notes described in the mortgage. We confidently insist that such a gross disregard of their duties as trustees for the stockholders cannot be, and is not, upheld by any law or rule known to our jurisprudence, and that is equally true where no moral turpitude is involved or even where the final net result might be of bene-

fit to the corporation. For what the law jealously seeks to prevent is the possibility of fraud or the temptation to perpetrate fraud or the securing of personal advantage on the part of those who occupy this fiduciary relation to the stockholders. The validity of their act is not governed by the *possible* result or even by the *probable* result. The limitations on the powers of the trustees are as definitely fixed as those of an administrator, and the court wel knows that such a proceeding as is attempted here would not be sustained if brought about by an administrator.

It is contended that by giving this deed the Brewing Company had six months more time in which to redeem the property than it would have had if the foreclosure suit had gone to a decree. We know of no authority upholding that defense even if the fact was demonstrated. No such fact may be assumed. The decree referred to might have been in defendant's favor. It will be noticed that one of the defenses in the foreclosure suit, made under oath by the defendant Schade was that he was mentally incompetent to execute the notes sued upon. (See, Trans. p. 150-1) Why can it be assumed as against this plaintiff stockholder that the plaintiff in the foreclosure suit would get any decree at all in that case? If the law says that Schade was legally incompetent to make the deed conveying away all of the corporate property—and Schade himself swears that he was mentally incompetent to make the notes and on that ground defended the foreclosure suit—

what right have we to assume that the corporation received even the benefit of six months extra time for redemption? May we not quite as well assume that the complaint would have been dismissed?

Plaintiffs and intervenor bought this stock under the guarantee of the statute that they would not be deprived of their interest in the corporation except in the manner provided by law. That and only that was their security. They never supposed and had no reason to suppose that a mortgage was placed on the property and suit was started to foreclose same that they would be deprived of the right to have it sold at public auction under the statute if a decree was secured by the mortgagee.

What the plaintiff and intervenor have lost by this transaction is:

1. The right to have the property disposed of by the trustees duly authorized and acting as required by law.

2. A valid consideration without any special privilege being given to the Schades in the way of free rent or release from their obligations.

3. The right to a full and complete defense in the mortgage foreclosure suit which Schade swears then existed.

4. The right to have the property—if foreclosure was granted—sold at public auction as provided by law.

5. The right if the corporation was dissolved—as it has been by the sale of its entire assets—to have it done as provided by law with the right to appear and object.

What the bank got through this transaction was:

1. Relief from a perfect defense according to the oath of President Schade.

2. The entire assets of the corporation for about $63,000.00, though it is not denied that their value is many times that amount.

What the Schades, Trustees, got was:

1. Relief from their obligations as signers of the notes.

2. The option to use the property free of rent for eighteen months.

What the plaintiff and intervenor stockholders got after sustaining the losses above enumerated was—nothing.

We submit that this proceeding cannot receive the sanction of a court of equity.

As to plaintiff and intervenor doing equity—they cannot be required to do equity for there is no equity to do. They have received nothing to which the bank is entitled. They have not received any benefit by the transaction. They have lost by it thus far. The Court should not place itself in the position of guardianship of the bank, for it has

deliberately and with full notice placed itself in its present position. The law charges it with full knowledge of the illegality of its acts. It also had actual notice, and it was surrounded by and was acting under the advise of its staff of capable attorneys. It cannot be that a person dealing with a corporation can deliberately plunge along and invalid course and then demand equity when halted? If, however, appellants are mistaken, and the rule is that one cannot really fail in an attempt to perpetrate a fraud—constructive or actual—and that though he may not get all that he went after he cannot lose anything in the attempt, then, the bank has pursued a proper course.

This plaintiff and intervenor cannot tender the amount of the alleged indebtedness of the Brewing Company to the bank, and to say that they must do so, is to measure their rights as stockholders, trying to undo the illegal acts of the defendants, by the amount of money they may possess. They are asked to pay the piper though they did not dance and were not invited to do so. This question resolves itself into this: Can an illegal transaction like this be put through if the minority dissenting stockholders cannot raise the money to make one of the offending parties whole? It is inconceivable.

Respectfully submitted,

CALEB JONES AND POST, RUSSELL & HIGGINS. Solicitors for Appellants.

Service of the foregoing brief by the receipt of a copy thereof is hereby acknowledged this ———— day of August, 1921.

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Solicitors for Appellee, Spokane & Eastern Trust Company.